



Office of Governmental Affairs
P.O. Box 942720
Sacramento, CA 94229-2720
Telecommunications Device for the Deaf - (916) 795-3240
(916) 795-3689, FAX (916) 795-3270

December 18, 2006

AGENDA ITEM 9a

TO: MEMBERS OF THE INVESTMENT COMMITTEE

- I. SUBJECT:** State Legislative Proposal: Supplemental Contributions Program – Employer Contributions
- II. PROGRAM:** Legislation
- III. RECOMMENDATION:** Staff recommends that the Board **sponsor** legislation to accept public agency and school employer contributions on behalf of participating employees and expand eligibility to all California public agencies.

IV. ANALYSIS:

Staff recommends that the CalPERS Board of Administration sponsor legislation to give the Board authority to accept employer contributions on behalf of participating employees in the Supplemental Contribution Plan (SCP) and provide for permissible in-service distributions of employee contributions. Staff additionally recommends expanding eligibility for participation to all California public agencies, including school employers, and their employees that contract for the SCP, without regard to membership in the CalPERS defined benefit pension plan.

This proposal will provide eligible employers and employees with a flexible plan to better meet their changing needs for supplement retirement income. Members will be able to benefit from the receipt of employer contributions into the plan on their behalf. Members will also be able to roll over funds from other eligible plans into the SCP to consolidate their retirement savings under CalPERS.

Background

CalPERS Supplemental Savings Program currently administers the Supplemental Contributions Plan (SCP), which is a defined contribution plan that qualifies for favorable tax treatment pursuant to Internal Revenue Code (IRC) section 401(a). As currently structured, the SCP is a money purchase pension plan with an employer contribution rate of zero percent.

Eligibility to participate in the SCP is presently limited to employees of the State of California who are active members of the CalPERS Defined Benefit (DB) Plan, the Legislators' Retirement System, the Judges' Retirement System, or the Judges

Retirement System II. The Board currently has statutory authority to extend participation in the SCP to include school and public agency employees who are active members of the CalPERS defined benefit plan.

Participation in the SCP is voluntary. Participants may contribute any amount at any time on an after-tax basis, subject to a minimum contribution of twenty-five dollars per month and the maximum aggregate annual addition permitted under section 415(c) of the IRC, which is the lesser of 100 percent of an employee's compensation or \$44,000. This annual addition limit includes both employer and employee contributions. The current SCP does not provide for employer contributions.

In addition, statutes governing the SCP do not provide for in-service withdrawals of employee contributions and limit eligibility for participation to members of the Public Employees' defined benefit pension plan, the Legislators' Retirement System, the Judges' Retirement System, and the Judges Retirement System II.

Discussion

CalPERS administers three supplemental deferred compensation (DC) plans. The **first** DC plan is a governmental plan (the "457" plan) that is available to employees of all California local public agencies, county superintendents of school offices, and school and community college districts that elect to contract for it. The **second** DC plan is the SCP, which is a money purchase pension plan under section 401(a) of the IRC and is only available to state employee members of the CalPERS defined benefit plan. The **third** DC plan is the State Peace Officers' and Firefighters' (POFF) Plan, which is also a money purchase pension plan under section 401(a) of the IRC that receives specified employer contributions for members of certain collective bargaining units in state service.

Public agency and school employers typically offer their employees 457 plans by contracting for investments, administration, and participant enrollment and education. All local public agencies have the ability to contract with CalPERS to offer the CalPERS 457 Plan. CalPERS frequently responds to RFP's issued by local public agencies and school employers.

In responding to these RFP's, CalPERS is increasingly encountering requests to provide a 401(a) DC plan in conjunction with its 457 Plan. Many employers use a 401(a) DC plan to receive employer contributions either for designated management employees or as a general employer match for voluntary contributions made by employees to the 457 plan. A 401(a) DC plan can be useful in this way because employer contributions to a 401(a) plan do not count against the voluntary employee contribution limits of the 457 plan. Where employers are inclined to provide a contribution, a 401(a) plan may be an attractive vehicle because employee contributions to the 457 plan remain unaffected.

Public employer contributions to a DC plan are not widespread among smaller agencies but are fairly prevalent among larger agencies. Larger agencies are also

more prone to issuing RFP's for DC services, and typically request comprehensive proposals covering all of the plans they offer, including 457 and 401(a) plans.

A number of agencies currently contracting for the CalPERS 457 Plan have asked if and when CalPERS would also be able to offer a 401(a) plan. Some of these agencies include CalPERS' largest clients, such as the cities of Anaheim, Santa Maria, El Monte, Yuba City, the County of Nevada, Vista Irrigation District and the San Diego City School System.

Amending the SCP to allow permissible in-service distributions of employee contributions could improve the utility of the plan by enabling participants to have access to their funds in certain instances. Currently, participants cannot access their funds until they separate from employment. Some participants may be hesitant to invest in the plan to their full potential because of this inability to access funds in an emergency. This is particularly pertinent since employee contributions to the plan are after-tax and only the earnings are tax-deferred.

Legislative History

- 1999 Chapter 307 (SB 522, Wright) — Deleted the SCP provisions and added new plan provisions to separate part of the Government Code to ensure the plan would operate as a separate tax-qualified DC plan pursuant to IRC section 401(a). Additionally, the bill provided for frequent valuations and crediting of earnings to participant accounts, as well as the structure necessary to improve customer service. *CalPERS' Position: Sponsor.*
- 1994 Chapter 576 (AB 2722, Cannella) – Extends to all active members of CalPERS the opportunity to participate in a defined contribution program for the purpose of supplementing their retirement benefits. This bill also establishes an identical program for active members of the Legislator's Retirement System. *CalPERS' Position: Sponsor.*
- 1993 Chapter 174 (AB 701, Tucker) – Permits any eligible state member to make additional contributions to the CalPERS defined benefit plan solely at the option and expense of the member. Employer contributions were prohibited and the cost of administration had to be paid solely from the additional member contributions. *CalPERS' Position: Neutral*
- 1992 Chapter 1321 (AB 2283, Elder) – Reactivated the Additional Contributions Program and permitted certain state peace officer and firefighter members to make additional contributions. The provisions of this bill were limited to only a portion of the state peace officer / firefighter member category. *CalPERS' Position: Oppose unless amended*
- 1982 Chapter 1220 (SB 1579, Foran) – Terminated participation in the Additional Contributions Program on a prospective basis by specifying that only those members and employers that filed an election on or before June 30, 1983, were permitted to make additional contributions after that date. *CalPERS' Position: Support*

Proposed Changes

Staff recommends that the CalPERS Board of Administration sponsor legislation to:

- Grant authority to the Board to authorize and accept the receipt of employer contributions on behalf of participating employees in the SCP plan. Any such contributions must be made in compliance with the Internal Revenue Code's "definitely determinable" requirement for money purchase pension plans, which provides that the formula for making contributions must be stipulated in a manner that is not subject to employer discretion.
- Provide for permissible in-service distributions of employee contributions.
- Expand eligibility for participation in the plan to all California public agencies, including school employers, and their employees that contract for the SCP without regard to membership in the CalPERS defined benefit pension plan.

These proposed changes would provide eligible employers and employees with another DC plan option to their supplemental retirement savings needs.

V. STRATEGIC PLAN:

Goal V of the Strategic Plan states that CalPERS will "Provide sustainable pension benefit products and services responsive to and valued by members, employers, and stakeholders." Meeting the employer demand for a 401(a) plan product capable of receiving employer matching contributions will benefit 457 plan participants by preserving their ability to make voluntary contributions to the maximum limit of their 457 plan while receiving additional employer contributions.

VI. RESULTS/COSTS:

By giving the Board authority to amend the SCP as described to provide additional flexibility, CalPERS and interested employers and eligible employees would not incur the initial start-up costs for a new DC plan. As an existing plan, the SCP has a current asset base of \$21.8 million.

Program Costs

Expanding the flexibility of the SCP to accept new sources of contributions would contribute to the growth of funds within the SCP, reduce the impact of ongoing administrative costs on current participants' SCP accounts, and spread the costs of recordkeeping the plan over a broader base. By offering the SCP as a complementary plan to the CalPERS 457 Plan, the synergistic effects of providing a complete package of plan options using a common recordkeeping platform will increase participation and reduce administrative costs for both.

Administrative Costs

There should be no additional administrative costs as CalPERS recent competitive negotiation solicitation (CNS) to select a third-party administrator (TPA) for the Supplemental Savings Program included the assumption of the recordkeeping and administration functions of the SCP as part of the scope of work for the TPA.

Danny Brown, Interim Chief
Office of Governmental Affairs

Gloria Moore Andrews
Deputy Executive Officer – Operations

Geraldine Jimenez, Division Chief
Supplemental Savings Program

Anne Stausboll
Assistant Executive Officer – Investment Operations

Russell Read
Chief Investment Officer